In the Supreme Court of the United States

OCTOBER TERM, 1969

No. 1482

BENJAMIN A. STRATMORE and
HELEN STRATMORE, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the district court (Pet. App. 45a-55a) is reported at 292 F. Supp. 59. The opinion of the court of appeals (Pet. App. 1a-19a) is reported at 420 F. 2d 461.

JURISDICTION

The judgment of the court of appeals was entered on January 6, 1970 (Pet. App. 20a). Petitioners

timely filed a petition for rehearing, which was denied on January 29, 1970 (Pet. App. 21a). The petition for a writ of certiorari was filed on April 25, 1970. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether, in the circumstances, petitioners failed to prove that they were entitled to business bad debt losses under Section 166(a) and (d) of the Internal Revenue Code, on payments made by them as guarantors of the debts of corporations of which they were employees and stockholders.[1]

2. Whether the court of appeals abused its discretion by refusing to remand the case so that the record could be reopened to permit petitioners to introduce additional evidence.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of Sections 166 and 1211 of the Internal Revenue Code of 1954 and Section

---

[1]Petitioners also purport to raise the question whether, under Section 165(c)(2) of the Code, the payments should be considered deductible as losses incurred in a transaction entered into for profit (see Pet. 2, question (b)). However, they do not discuss this question in the body of the petition, and we know of no reason why it should be reviewed here. Upon the authority of this Court's decision in *Putnam* v. *Commissioner*, 352 U.S. 82, both courts below correctly held (Pet. App. 6a-8a, 48a) that the losses in dispute were bad debt losses, deductible if at all under Section 166.

BLEED THROUGH, POOR COPY

1.166-5 of the Treasury Regulations on Income Tax (1954 Code) are set forth in the Appendix to the petition (Pet. App. 22a-25a).

STATEMENT

Petitioners endorsed the notes of two corporations of which they were employees and stockholders. Without petitioners' personal endorsements on the corporations' notes, the loans would not have been obtained and the corporations would have ceased to function. When petitioners guaranteed the corporations' notes, they expected that the borrowed funds would be used to increase their salaries and would enhance the value of their proprietary interests in the corporations. Both corporations filed voluntary petitions in bankruptcy in 1957 and, with the exception of petitioners who had agreed to refrain from filing their claims, paid all of their creditors 25 percent of the amount due. After each corporation's discharge from bankruptcy in December, 1958, petitioners entered into agreements with certain creditors, who held the corporations' notes endorsed by petitioners, to pay another part of the debt in full settlement of their obligations as endorsers or guarantors. Pursuant to the agreements, petitioners paid these creditors $17,088 in 1959. (Pet. App. 2a-3a, 45a-47a.)

In their income tax return for that year, petitioners treated the $17,088 as a nonbusiness bad debt under Section 166(d) of the Code. As such, deductibility was limited to $1,000 under Section 1211(b).

Thereafter, petitioners filed an amended income tax return in which they claimed a deduction for $17,088 under Section 165(c)(2), as a loss from a transaction entered into for profit not connected with their trade or business. No action having been taken on their claim for refund within six months, petitioners brought this refund suit in the district court. Therein they contended that their loss was fully deductible either under Section 165(c)(2) or, in the alternative, under Section 166(a) as a bad debt loss incurred in a trade or business. (Pet. App. 3a, 29a, 32a, 47a-48a.)

The district court rejected petitioners' claim under Section 165(c)(2) but held that the loss was fully deductible under Section 166(a) (Pet. App. 53a). On appeal, the Third Circuit affirmed on the first issue and reversed on the second. That court held that only a nonbusiness bad debt loss was available to petitioners because they had failed to prove that their expenditures as guarantors of the corporations' notes were proximately related to their trade or business of being employees. The court of appeals also refused to remand the case to the district court so that petitioners could reopen the record and present additional evidence on that point. (Pet. App. 6a, 8a.)

ARGUMENT

The decision below is correct. There is no conflict or any other reason for further review by this Court.

1. Section 166(a) and (d) of the Code provides that an individual taxpayer may deduct a bad debt

in full only if it is created or acquired in connection with, or the loss therefrom is incurred in, the taxpayer's trade or business. Under subsection (d), a nonbusiness bad debt loss is treated as a short-term capital loss deductible to the extent of $1,000 per year or the taxpayer's taxable income, whichever is less. Section 1211(b). The question presented here is whether the loss incurred by petitioners as guarantors of the notes of the corporations constitutes a business or a nonbusiness bad debt. Resolution of that question depends on whether the guarantees were proximately related to petitioners' trade or business of being employees. *Whipple* v. *Commissioner*, 373 U.S. 193, 201; Treasury Regulations on Income Tax (1954 Code), Section 1.166-5(b)(2); H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 76-77; S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 90-91. This in turn depends on their motivation in making the guarantees. See *Weddle* v. *Commissioner*, 325 F.2d 849 (C.A. 2); *Niblock* v. *Commissioner*, 417 F.2d 1185 (C.A. 7).

As petitioners correctly point out (Pet. 8), two motivation tests have developed for determining deductibility in these circumstances. Under the primary or dominant motivation test adopted by the Seventh Circuit in *Niblock* v. *Commissioner*, *supra*, a guarantee payment will be deductible as a business bad debt loss by a stockholder-employee only if his interest as an employee is the dominant motivation for the guarantee of the corporate debt. Under the significant motivation test of the Second Circuit, *Weddle* v. *Commissioner*, *supra*, such a loss will be

allowed so long as the guarantee is motivated in significant part by his interest as an employee. While there thus is a difference of opinion between the Seventh and Second Circuits as to the proper test to be applied, that difference has no bearing on the outcome of this case. Here, the court below, including the dissenting judge, determined (Pet. App. 5a, 14a) that even under the less stringent significant motivation test, petitioners had failed to meet their burden of proving that their loss on the guarantee transactions was proximately related to their trade or business of being employees.

The only record evidence on the point is the stipulation (Pet. App. 42a) that the loans were made "with the expectation that said corporations' use of these funds would provide them [petitioners] with increased receipts by way of salary and enhance the value of their proprietary interests in said corporations." Such evidence could suffice only under a test that permitted a business bad debt deduction so long as a stockholder-employee's guarantee was motivated in any degree by his interest as an employee. There is no authority for such a test.[2]

2. Equally inappropriate for review by this Court is petitioners' claim (Pet. 11-15) that the court below

---

[2] Petitioners do not make clear the intended direction of their argument (Pet. 9-10) that the court below failed to give the language of the stipulation as broad a meaning as do petitioners. We submit that petitioners' reading is greatly strained; but, in all events, the determination of the intended meaning of the language of a particular stipulation in a particular case is not a matter warranting the attention of this Court.

abused its discretion by refusing to remand the case so that the record could be reopened for the taking of additional evidence. Petitioners concede (Pet. 12-13) that they could have presented this evidence at trial, but they failed to do so. There is here no mistaken understanding of the facts as in *Laird* v. *Air Carrier Engine Service*, 263 F.2d 948 (C.A. 5), and in *Maryland Casualty Co.* v. *Rickenbaker*, 146 F.2d 751 (C.A. 4), no mistaken understanding of the law or legal theory as in *Knight Newspapers* v. *Commissioner*, 143 F.2d 1007 (C.A. 6), *Aetna Life Insurance Co.* v. *Barnes*, 361 F.2d 685 (C.A. 5), and *Boston Edison Co.* v. *Campanella & Cardi Const. Co.*, 272 F.2d 430 (C.A. 1), and no other circumstance for which courts sometimes have relieved a party from a stipulation of fact (Anno., Relief from stipulations, 161 A.L.R. 1161, *et seq.*). Indeed, petitioners do not seek to be relieved of the stipulation, but rather of the consequence of having relied exclusively thereon to meet their burden of proof. Even if, as they assert (Pet. 12), the requirements of the law in this area were uncertain at the time of trial, it was hardly excusable neglect for them to withhold any available evidence in support of their claim under the significant motivation test. Accordingly, the court of appeals did not abuse its discretion in failing to remand the case so that the record could be reopened.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General.

JOHNNIE M. WALTERS,
Assistant Attorney General.

WILLIAM FRIEDLANDER,
DAVID ENGLISH CARMACK,
Attorneys.

MAY 1970.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1970 382267 716

BLEED THROUGH POOR COPY